

6155-3
card
*W/-
02
553.
#7651
1/15/58
C1

OFFICIAL USE ONLY

LR
RECORD
COPY

Intelligence Report

DEPARTMENT OF STATE
LIBRARY DIVISION

No. 7651

JAN 30 1958

LR FILE COPY
PLEASE RETURN

JAPAN-USSR ECONOMIC AGREEMENTS

DEPARTMENT OF STATE



Office of Intelligence Research
and Analysis

Prepared by
Division of Research and Analysis for Far East
January 15, 1958

THIS IS AN INTELLIGENCE REPORT AND NOT A STATEMENT OF DEPARTMENTAL POLICY

OFFICIAL USE ONLY

OFFICIAL USE ONLY

This report is based on information available through December 24, 1957.

TABLE OF CONTENTS

	<u>Page</u>
Abstract	11
I. Introduction	1
II. Substance of the Agreements	1
A. Trade and Payments Agreement	1
B. Treaty of Commerce and Navigation	1
C. Exchange of Notes on Shipping	2
D. Negotiations	2
III. Soviet and Japanese Reactions	3
IV. Past Trade	4
V. Outlook	5
A. Soviet Export Commodities	6
B. Economic Obstacles	8
C. Shipping	8
D. Political Factors	8

Abstract

Japan and the USSR signed a trade and payments agreement and a treaty of commerce and navigation in Tokyo on December 6, 1957. These are the first formal agreements of this type between the two countries since the founding of the Soviet Union. An outgrowth of the Japan-USSR declaration a year ago ending the state of war and reestablishing diplomatic relations, the agreements foreshadow some increase in trade above the very low levels of recent years. However, at least for some years to come various economic and political factors, including the introverted nature of Soviet Bloc trade and the relative scarcity of suitable material to export, as well as Japan's political and economic ties with the West, will probably continue to limit the trade to only a very small fraction of each country's total foreign commerce.

OFFICIAL USE ONLY

I. INTRODUCTION

Following almost three months of negotiations in Tokyo, the USSR and Japan on December 6, 1957 signed a trade and payments agreement and a treaty of commerce and navigation. At the same time, the desirability of instituting regular merchant shipping services between the USSR and Japan was acknowledged in an exchange of notes. The negotiations were an outgrowth of the Japan-USSR Joint Declaration of December 19, 1956, which terminated the state of war and reestablished diplomatic relations between the two countries, and which provided also that they would "enter into negotiations as soon as possible for the conclusion of treaties or agreements to place their trading, maritime, and other commercial relations on a stable and friendly basis." An interim protocol signed simultaneously with the Joint Declaration had already established the principle of most-favored-nation treatment in trade and shipping as formalized in the new treaty of commerce and navigation.

II. SUBSTANCE OF THE AGREEMENTS

A. Trade and Payments Agreement

The Trade and Payments Agreement became effective for one year upon signature, and will be renewed automatically for succeeding yearly periods unless denounced by either party. It lists goods which may be shipped during the coming year, reportedly constituting an export target of \$28,000,000-\$30,000,000 for each side. Major commodities listed for shipment by the USSR include lumber and coal, as well as ores, chemicals, and petroleum. The Japanese export list includes fishery vessels, rolling stock, a variety of machinery, iron and steel, copper wire, and synthetic yarns and fibers. The agreement provides for payments of trade in transferable pounds sterling, although special barter transactions may also be authorized.

B. Treaty of Commerce and Navigation

The Treaty of Commerce and Navigation, which will enter into force following ratification, will be effective for five years. It guarantees each country most-favored-nation treatment with respect to tariffs, customs procedures, exportation, importation and distribution of goods, and the entry and treatment of ships. Exceptions to MFN treatment are permitted to protect the national security (a concession to Japan's COCOM commitments) or international financial reserves. In addition, the treaty provides for the establishment of a Soviet trade mission in Japan. Under an annex to the treaty, also signed on December 6, the trade mission will be considered as a part of the Soviet Embassy in Tokyo. Diplomatic privileges will be accorded only to the chief of the trade mission and his two principal assistants, although the entire staff will be exempted from Japanese taxation on its official income.

OFFICIAL USE ONLY

OFFICIAL USE ONLY

- 2 -

The size of the Soviet trade mission and the opening of any branches outside of Tokyo shall be subject to the approval of the Japanese Government.

C. Exchange of Notes on Shipping

The notes exchanged between the chiefs of the Soviet and Japanese delegations acknowledged the desirability of establishing regular merchant shipping services between the USSR and Japan. Negotiations on tariffs, schedules and appointment of agents are to begin in Tokyo as soon as possible between representatives of Soviet and Japanese shipping lines. Government officials are to participate in the discussions if questions arise that require intergovernmental agreement.

D. Negotiations

Extensive Japanese press reports of surprise proposals and counter-proposals by both sides appeared at times to indicate that the Tokyo negotiations were turbulent. However, in retrospect it seems that compromise solutions were reached readily on all major points. The Soviet negotiators agreed to Japanese demands for direct settlement of trade in sterling (rather than by barter or open account), permissive rather than binding trade goals, and MFN exceptions for security and, reportedly, payments reasons. The Japanese conceded on establishment of the Soviet trade mission, considered a major goal of the USSR; also, on the treaty of commerce and navigation itself, which Japan at first wished to avoid for fear the Soviets would seek impossible privileges.

One relatively minor issue delayed the conclusion of the trade talks. Japan could not obtain specific Soviet approval to have only one Japanese agency handle all trade, which would place Japanese traders in a stronger position vis-a-vis the Soviet foreign trade monopolies. The issue was finally resolved by the adoption of generalized and inconclusive language ("Permission for the import and export of the merchandise ... shall be based on contracts to be concluded between juridical and natural persons of Japan on the one hand, and the foreign trade organizations of the USSR on the other"), which the Japanese consider is broad enough to permit establishment of a single organization to control and direct trade with the USSR.

During the course of the negotiations, a Soviet representative proposed a formal shipping agreement between the two governments, similar to the one in effect between the USSR and India, to establish and to govern liner services. The Japanese refused on the grounds this is a matter for negotiation by the interested shipping lines. The compromise solution was the exchange of notes calling for early discussions by Soviet and Japanese shipping representatives.

OFFICIAL USE ONLY

III. SOVIET AND JAPANESE REACTIONS

Both sides appear pleased with the outcome of the negotiations. The agreements, the first of this type which the Japanese Government has concluded with any Communist country, were hailed in a Moscow broadcast as heralding an era of increased trade between the USSR and Japan. PRAVDA commented that the proposed balance in trade for Japan contrasts favorably with the sharp deficit which Japan incurs in its trade with the United States. Soviet comment noted thus far stresses the importance of the trade accords in developing friendlier relations; PRAVDA referred in one sentence to the signing of the agreements, peaceful coexistence, and renunciation of a policy of military blocs.

All major political parties in Japan have welcomed the agreements as a logical step to expand trade. The Socialists and Communists, who are pressing the government for closer relations with the Sino-Soviet Bloc, have gone out of their way to praise the agreements. The incumbent Liberal-Democrats are apparently happy to have this new public evidence of their devotion to the popular cause of more normal relations with the Bloc.

The Japanese Government has expressed the hope that the agreements will result in more fruitful trade relations but has been cautious not to over-estimate their effect. One of the main benefits of the agreements, from the government's viewpoint, is that they may sweeten the atmosphere surrounding other Japan-USSR issues. The government hopes, for example, that the Soviets will be more liberal than last year in fixing the Japanese quota for the North Pacific salmon catch; negotiations on the 1958 quota are to begin this month. The government also hopes for a more amenable Soviet position on Japanese fishing off the Southern Kuriles and the Siberian coast, where Japanese fishermen have been hounded by Soviet patrol craft.

Various elements of the Japanese business community, particularly in the associations founded to further trade with the Bloc, had forecast a very bright future for Japan-USSR trade if only the official agreements were negotiated. Faced now with the reality of moving goods under the agreements, there appears to be some moderation of enthusiasm. More responsible opinion, reflected among the larger and better informed business interests, has been consistently rather cautious about the possibilities of doing business with the Soviets, and now seems to parallel the government's hopeful but "wait-and-see" attitude.

OFFICIAL USE ONLY

- 4 -

IV. PAST TRADE

A sharp increase in the second half of 1957 has brought Japan's trade with the USSR to a higher level than in any year since the 1930's. Nevertheless, the \$10,600,000 two-way figure for the first nine months of 1957 (latest data available) represented only 0.2 percent of Japan's total foreign trade.

Trade with the USSR has invariably accounted for an insignificant part of Japan's total world commerce. In the peak period -- 1930-35 -- Japan's exports to the USSR amounted to only 1.1 percent of its total exports, and imports from the USSR were only 2.6 percent of total imports. In the highest single year of trade (1930), Japan exported \$13,500,000 to the USSR (1.9 percent of Japan's world total) and imported \$21,400,000 from the USSR (2.8 percent).¹ Even excluding the unusual decade of the 1940's, since 1920 the USSR has accounted for only 0.4 percent of Japan's total exports and only 0.6 percent of its total imports. The following table gives summary of Japan's average annual trade with the USSR, in millions of dollars, and the percentages of such trade to Japan's total exports (f.o.b.) and imports (c.i.f.):

	Exports		Imports	
1920-29	\$4.9	(0.6%)	\$8.3	(0.8%)
1930-39	\$5.9	(0.9%)	\$9.2	(1.3%)
1940-49	\$1.3	(0.09%)	\$0.9	(0.02%)
1950-56	\$0.5	(0.03%)	\$1.7	(0.08%)
Jan.-Sept. 1957	\$1.3	(0.06%)	\$9.3	(0.3%)

Comparative figures are not available to show the importance to the USSR of its trade with Japan. However, in the decade 1947-56 it is estimated that about 0.3 percent of the USSR's total imports from the free world came from Japan, and that 0.5 percent of its total exports to the free world went to Japan. These percentages would be substantially smaller, of course, if the comparison could be made in terms of the USSR's total foreign trade, including its trade within the Sino-Soviet Bloc.

1. The prewar figures given above do not include trade between Japan Proper and Southern Sakhalin or the Kuriles. Such trade was considered a part of Japan's domestic commerce. Data are not available on the value of prewar trade with the Kuriles, but such trade was relatively insignificant. On the other hand, exports from Japan Proper to Southern Sakhalin in the decade of the 1930's are estimated to have been somewhat more than double Japan's exports to the USSR; imports from Southern Sakhalin appear to have been three to four times greater than Japan's imports from the USSR. Prewar trade with Southern Sakhalin cannot be treated as foreign trade, because it was fully controlled by Japan in support of Japanese national policy and under procedures identical with those applying to domestic commerce.

Almost two-thirds of Japan's imports from the USSR in the first nine months of 1957 were received in the July-September quarter. Although Japan's exports lagged behind, recently reported trade contracts, predating the December 6 agreements, may add substantially to Japan's shipments.'

Japan's major exports to the USSR in the 1930's included a wide variety of machinery and other metal products, textile products, other varied manufactures, and tea. Japan imported fish products, pig iron, petroleum, coal, minerals, and logs.

In 1956, conifer logs and coal each accounted for some 40 percent of Japan's imports from the USSR, and chrome and manganese ores made up most of the balance. The ores, a small part of the logs, and a variety of lesser imports were reported as coming from USSR-in-Europe, while USSR-in-Asia supplied the remainder or more than three-fourths of Japan's total imports from the USSR. Almost one-half of Japan's imports from the USSR in January-September 1957 came from Southern Sakhalin and the Kuriles; major imports this year have been coal (especially coking coal from Southern Sakhalin), logs, and ores. The small volume of Japanese exports to the USSR in the first nine months of 1957 ranged over a wide list of manufactured products. Contracts reportedly concluded recently or under discussion call for Japanese shipments of steel sheets (\$5,000,000), bearings (\$850,000), rayon yarn (\$2,000,000), and rubber belting (\$1,860,000).

V. OUTLOOK

The recent spurt in Japan-USSR trade may foreshadow continued development of this trade to a level well above the insignificant figures of the past. Sufficient economic basis appears to exist for further development. Japan is pressed for new markets and cheaper sources of raw materials. Geographic proximity to the Soviet Far East reduces freight costs and thus compensates for price disadvantages. Japan has the ability to supply a wide range of industrial products. The prospect of becoming a major supplier of capital goods for the development of the Soviet Far East, a subject which pops up repeatedly in Japanese discussions of trade with the USSR, is an alluring one. Expansion of sales to the USSR of fishery vessels, rolling stock, iron and steel, copper wire, machinery, synthetic yarns, and other manufactures to the target level of \$28,000,000-30,000,000 set in the recent trade agreement would be comfortably within the capacity of Japanese industry. However, even at the target figure, Japan's exports to the USSR would constitute less than one percent of Japan's overall export goal for the coming year.

Should the target for imports from the USSR be met in the coming year, it would represent a similarly low figure of under one percent of Japan's expected import total. However, although Japan traditionally has incurred a deficit in its trade with the USSR, in the future it may be more difficult for Japan to find suitable Soviet goods for import than to build up an export market in the USSR.

The USSR has nurtured Japanese hopes of greatly expanded trade. In 1956, before the agreement to end the state of war and reestablish diplomatic relations was concluded, the then Foreign Minister Shepilov conjured up the sum of \$250,000,000 as a reasonable trade goal for the USSR and Japan within a period of five years. That fanciful figure has not been revived by Soviet sources of late, but the USSR will probably continue to dangle a carrot of increased trade before Japanese eyes. On the other hand, it does not appear likely at this time that the USSR will be inclined to enter into substantially increased trade with Japan except when it serves Soviet political or economic ends. The Soviet program of rapid expansion in its Far Eastern areas could probably be assisted to advantage by Japan's industrial plant. If domestic industrial and communications bottlenecks should become intolerable, the USSR might profitably tap Japanese surpluses to help meet Soviet commitments for deliveries to Communist China and North Korea. The USSR might make a special effort to provide key raw materials on favorable terms, if it could obtain from Japan ships or machines which it desires but cannot obtain from other free-world sources. By and large, however, it would appear that neither political nor economic considerations will assume enough importance for the USSR, in the years immediately ahead, to impel it to expand its trade with Japan to the point that such trade would constitute any substantial percentage of either country's total foreign commerce.

A. Soviet Export Commodities

The new trade agreement lists 500,000 cubic meters of lumber (including logs) for shipment by the USSR during the coming year. On the basis of past shipments this volume would be valued at perhaps \$10,000,000, or one-third of the year's total target. Only 60,000 cubic meters of Soviet forest products were imported by Japan in 1956. They consisted entirely of conifer logs, understood to be used mainly in construction, and constituted about 40 percent of Japan's imports of such logs during the year. If the coming year's target is to be met, the USSR would presumably have to supply a large proportion of non-conifer logs, which make up the great bulk of Japan's wood imports, and perhaps also pulpwood. The prospect for sufficiently rapid expansion of Soviet shipments of wood to meet the coming year's trade target seems poor. A long-range major expansion

of deliveries to Japan would appear to depend on a fundamental change in the Japanese market, even assuming that the USSR were willing to step up shipments from its substantial Asian forests.

Japan could consume a great deal more coal, especially coking coal, from Soviet Asia, both to meet expanding domestic needs and possibly to replace coal now imported from other more distant sources (e.g., the United States). Only 75,000 metric tons of coal were imported from the USSR in 1956, but the figure was raised to 310,000 tons (or 7.3 percent of total coal imports) in January-September 1957. The recent agreement's target figure of 350,000 tons for the coming year (valued at perhaps \$7,000,000) appears feasible. However, continued substantial expansion of coal exports to Japan appears to depend on tapping some of the considerable deposits that reportedly are underexploited in inland Soviet Asian areas.¹

The new trade agreement calls for Soviet shipments of 20,000 metric tons each of chrome ore and manganese ore in the coming year. Such amounts appear to be easily within the ability of the USSR to supply and Japan to absorb. In 1956, Japan imported 5,200 tons of chrome ore from the USSR out of a total of 135,600 tons from all foreign sources, and 3,700 tons of Soviet manganese ore out of a total of 206,600 tons. On the basis of recent deliveries, the 20,000-ton targets would represent an import value of about \$880,000 for chrome and \$620,000 for manganese. These figures would appear to provide substantial room for expansion in following years.

Petroleum is another Soviet product in which the Japanese have shown interest. This interest has been centered on Sakhalin petroleum, with which the Japanese importers are familiar from prewar days. However, Soviet trade representatives have refused to commit themselves to ship oil from Far East sources, reportedly on the grounds it is all needed for domestic consumption. The recent trade agreement contains an export target of 100,000 metric tons of petroleum (crude and heavy oil) to be shipped from Black Sea ports. This appears to be in the nature of a proposed trial shipment, which the Soviets would be prepared to follow up in much greater quantities if the Japanese so desire. The range of the Japanese market is indicated by the 11,600,000 metric tons of crude oil and 3,200,000 tons of heavy oil imported by Japan in 1956, predominantly from the Middle East and to a lesser extent from Southeast Asia and the United States.

1. For a lengthier discussion of Japan's requirements of coking coal and iron ore, and of the possibility of supply from the USSR, see IR 7540, Japan's Iron and Steel Industry, Recent Developments and Future Plans, August 26, 1957, CONFIDENTIAL.

Iron ore might also become an important export to Japan, if extensive deposits in Soviet Asia were exploited. However, any such development would probably require a number of years.¹

B. Economic Obstacles

Although supply and requirements appear to provide an economic basis for trade expansion, the terms and balance of trade may be the determining economic factors. Japanese importers of Soviet goods have complained of difficulties over quality, failure to meet specification, uncertainty of delivery, and -- most important -- overpricing of goods in relation to world market levels. On the other side of the coin, it remains to be seen whether the USSR will find the quality and price of Japanese goods more favorable than those offered by other free-world countries. A difficulty on both sides stems from the lack of contact and mutual experience on the part of trade representatives, compounded by the continuing obstacles to free travel; establishment of the Soviet trade mission in Japan and increasing experience with trade may be expected to ease this defect. Both Japan and the USSR will probably want to maintain at least some approximation of balance in their trade. The Japanese have shown some sensitivity about their deficit in the past years, and in the recent trade negotiations in Tokyo reportedly stressed their intention of exporting to the USSR at least as much as they import.

C. Shipping

The new agreements will result in an increase in shipping between Japan and the USSR, now conducted only on an irregular basis. Ports most likely to benefit are Maizuru, Kobe, and Hakodate in Japan, and Nakhodka (Siberian Maritime Provinces) and Odessa in the USSR. The Japanese Ministry of Transportation is expected shortly to select one line each to negotiate with Soviet shipping representatives on opening the Japan-Nakhodka and Japan-Black Sea liner routes. Limited passenger service is expected to be available on the Japanese cargo vessels operating on the two routes.

D. Political Factors

In the final analysis, however, political considerations will continue to be the primary factor in Japan-USSR trade so long as East-West tensions persist. Japan is anti-communist, and by choice and the force of circumstances is a part of the free world. The Japanese Government, under Prime Minister Kishi, believes that Japan's welfare

1. See footnote, page 7.

and security as well as its economic well-being are served best by alignment with the West, and Japan's foreign policy is attuned to that end. It is possible that, if in the course of its cooperation with the West Japan should not be afforded the means and opportunity to earn a living, the Japanese might conclude that they had no alternative but to reach an accommodation with the Soviet Bloc in order to assure the nation's economic survival. For the foreseeable future, however, the economic as well as the political and military facts of life militate strongly against such a course of action. As most Japanese are aware, trade with the free world -- about 97 percent of the total foreign trade of the country in 1957 -- is the vital element in Japan's economic health. Even if the trade targets of the recent Japan-USSR agreement are met, Japan's exports to and imports from the USSR in the coming year would amount to only five percent and two percent, respectively, of actual trade with the United States in 1957 (nine-month rate).

Meanwhile, in the field of trade, Japan's cooperation with the free world assumes forceful reality through its adherence to COCCOM. The Japanese willingly sacrifice greater trade with the USSR by conforming to COCCOM export restrictions, which they forced the Soviets to accept at least implicitly in the recent trade negotiations.

Nevertheless, Japan feels compelled to keep open its trade lanes to the Soviet Bloc. At the very least Japan desires to reduce the localized political obstacles to trade with the USSR, and considers the restoration of diplomatic relations last year and the recent commercial agreements as the key steps to that end. Japan wishes to expand its trade with the USSR in non-strategic commodities, and, on occasion, will doubtless seek COCCOM approval for the shipment of other commodities when it feels the economic advantages are overriding. However, the Japanese know that the USSR manipulates trade for political reasons and will be cautious about becoming overly dependent on Soviet sources of key raw materials.

Political factors are even more important in the Soviet view of trade. Introversion of trade within the Bloc is considered an indispensable prop to politico-military power. The residual portion of Soviet foreign trade -- that with the free world -- is only a minor percentage of its total volume. The highly centralized nature as well as the size of Soviet economic power gives the USSR an advantage in its trade relations with Japan.

The Soviets will doubtless attempt to use the recent agreements in part for political ends. The agreements will be played up as an earnest of Soviet good will toward Japan. The permanent trade mission

OFFICIAL USE ONLY

- 10 -

may become an important channel for Soviet contacts with Japanese communists and for general subversive activity. The Soviets may be expected to seek greater freedom of travel within Japan for members of the trade mission than that granted by Japan to regular members of the Soviet Embassy. The Japanese Government, for its part, may be expected to take these factors into account in considering how large a mission staff to approve and whether to permit the mission to open branches outside Tokyo.